

Report of the Auditor-General

Elias Motsoaledi Local Municipality

30 June 2014

Report of the auditor-general to the Limpopo Provincial Legislature and the council on the Elias Motsoaledi Local municipality

Report on the financial statements

Introduction

1. I have audited the financial statements of the Elias Motsoaledi Local Municipality set out on pages ... to ..., which comprise the statement of financial position as at 30 June 2014, the statement of financial performance, statement of changes in net assets, cash flow statement and the statement of comparison of budget information with actual information for the year then ended, as well as the notes, comprising a summary of significant accounting policies and other explanatory information.

Accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act no 56 of 2003) (MFMA) and the Division of Revenue Act, 2013 (Act no. 2 of 2013) (DoRA) and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor-general's responsibility

3. My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA), the general notice issued in terms thereof and International Standards on Auditing. Those standards require that I comply with ethical requirements, and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.
4. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.
5. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified audit opinion.

Basis for qualified opinion

Property, plant and equipment

6. The municipality did not adequately test for and recognise impairment on items of property, plant and equipment taking into account impairment indicators that existed at the reporting date as required by SA Standards of GRAP 21 *Impairment of non-cash generating assets*. Furthermore, the municipality did not properly assess the appropriateness of residual values and useful lives of items of property, plant and equipment as required by SA Standards of GRAP 17 *Property, plant and equipment*. I was unable to confirm the appropriateness of the valuation of property, plant and equipment by other means. Consequently I was unable to determine whether any adjustment relating to property, plant and equipment stated at R694 622 993 in the financial statements was necessary.

Aggregation of immaterial uncorrected misstatements

7. The financial statements were materially misstated due to the cumulative effect of numerous individually immaterial uncorrected misstatements in the following items making up the statement of financial position and the notes to the financial statements:
- Receivables from exchange transactions reflected at R16 856 667 was understated by R3 943 105 (2013: R764 579).
 - Provision for long service leave and bonus reflected at R2 344 042 was understated by R495 934.
 - Payables from exchange transactions reflected at R33 320 406 was overstated by R785 307.
 - Consumer debtors from non-exchange transactions reflected at R14 559 351 was overstated by R3 941 701 (2013: R473 888).
 - Long term lease debtors reflected at R643 565 was overstated by R643 565.
 - The opening balance of the current year accumulated surplus reflected at R766 138 037 was overstated by R348 677.
 - The opening balance of the current year VAT Receivables reflected at R13 376 726 was overstated by R1 564 377

As a result, I was unable to determine whether any adjustment to these items was necessary.

Qualified opinion

8. In my opinion, except for the effects of the matters described in the basis for qualified opinion paragraphs, the financial statements present fairly, in all material respects, the financial position of Elias Motsoaledi Local Municipality as at 30 June 2014 and its financial performance and cash flows for the year then ended, in accordance with the SA standards of GRAP and the requirements of the MFMA and the DoRA.

Emphasis of matters

9. I draw attention to the matters below. My opinion is not modified in respect of these matters.

Restatement of corresponding figures

10. As disclosed in note 47 to the financial statements, the corresponding figures for 30 June 2013 have been restated as a result of an error discovered during 2014 in the financial statements of Elias Motsoaledi Local Municipality at, and for the year ended, 30 June 2013.

Irregular expenditure

11. As disclosed in note 53 to the financial statements, irregular expenditure amounting to R25 224 038 (2013: R18 470 492) was incurred as a result of the municipality procuring goods and services without following supply chain management requirements.

Material impairments

12. The municipality had consumer debtors totalling R51 670 581 at 30 June 2014. The recoverability of R30 033 445 of the total debtors are doubtful.

Additional matters

13. I draw attention to the matters below. My opinion is not modified in respect of these matters.

Unaudited supplementary schedules

14. The supplementary information set out on pages xx to xx does not form part of the financial statements and is presented as additional information. I have not audited these schedules and, accordingly, I do not express an opinion thereon.

Unaudited disclosure notes

15. In terms of section 125(2)(e) of the MFMA the municipality is required to disclose particulars of non-compliance with the MFMA. This disclosure requirement did not form part of the audit of the financial statements and accordingly I do not express an opinion thereon.

Report on other legal and regulatory requirements

16. In accordance with the PAA and the general notice issued in terms thereof, I report the following findings on the reported performance information against predetermined objectives for selected development objectives presented in the annual performance report, non-compliance with legislation as well as internal control. The objective of my tests was to identify reportable findings as described under each subheading but not to gather evidence to express assurance on these matters. Accordingly, I do not express an opinion or conclusion on these matters.

Predetermined objectives

17. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information for the following selected development objectives presented in the annual performance report of the municipality for the year ended 30 June 2014:
- Spatial rationale on pages xx to xx
 - Basic service delivery and infrastructure development on pages xx to xx

18. I evaluated the reported performance information against the overall criteria of usefulness and reliability.
19. I evaluated the usefulness of the reported performance information to determine whether it was presented in accordance with the National Treasury's annual reporting principles and whether the reported performance was consistent with the planned development objectives. I further performed tests to determine whether indicators and targets were well defined, verifiable, specific, measurable, time bound and relevant, as required by the National Treasury's *Framework for managing programme performance information (FMPPI)*.
20. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
21. The material findings in respect of the selected development objectives are as follows:

Spatial rationale

Usefulness of reported performance information

22. Section 41(c) of the Municipal Systems Act, 2000 (Act no. 32 of 2000) (MSA) requires the integrated development plan to form the basis for the annual report, therefore requiring consistency of objectives, indicators and targets between planning and reporting documents. A total of 36% of the reported objectives, 64% of the reported indicators and 82% of the reported targets were not consistent with those in the approved integrated development plan due to a lack of proper systems and processes for performance management.
23. Section 25(2) of the MSA determines that an integrated development plan adopted by a municipal council may be amended in accordance with the process as prescribed per section 34 of the MSA, and that such a plan remains in force until an integrated development plan is adopted by the next elected council. Material changes were made to the development objectives, indicators and targets in the annual performance report, without following the process as prescribed in section 28 of the MFMA and without adoption by the municipal council. This was due to lack of review by the management and the internal audit unit.
24. The FMPPI requires the following:
 - Performance indicators must be well defined by having clear data definitions so that data can be collected consistently and is easy to understand and use. A total of 55% of the indicators were not well defined.
 - Performance indicators must be verifiable, meaning that it must be possible to validate the processes and systems that produced the indicator/measure. A total of 100% of the indicators were not verifiable.
 - Performance targets must be specific in clearly identifying the nature and required level of performance. A total of 55% of the targets were not specific.
 - Performance targets must be measurable. I could not measure the required performance for 73% of the targets.
 - The period or deadline for delivery of targets must be specified. A total of 27% of the targets were not time bound.
25. This was because management did not adhere to the requirements of the FMPPI due to a lack of proper systems and processes and technical indicator descriptions.

Reliability of reported performance information

26. The FMPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets.
27. I was unable to obtain the information and explanations I considered necessary to satisfy myself as to the reliability of the reported performance information. This was due to limitations placed on the scope of my work due to the absence of information systems and the fact that the auditee could not provide sufficient appropriate evidence in support of the reported performance information.

Basic service delivery and infrastructure development

Usefulness of reported performance information

28. Section 41(c) of the MSA requires the integrated development plan to form the basis for the annual report, therefore requiring consistency of objectives, indicators and targets between planning and reporting documents. A total of 48% of the reported objectives, 57% of the reported indicators and 65% of the reported targets were not consistent with those in the approved integrated development plan due to a lack of proper systems and processes for performance management.
29. Section 25(2) of the MSA determines that an integrated development plan adopted by a municipal council may be amended in accordance with the process as prescribed per section 34 of the MSA, and that such a plan remains in force until an integrated development plan is adopted by the next elected council. Material changes were made to the development objectives, indicators and targets in the annual performance report, without following the process as prescribed in section 34 of the MFMA and/or without adoption by the municipal council. This was due to lack of review by the management and the internal audit unit.
30. The FMPPI requires the following:
- Performance indicators must be well defined by having clear data definitions so that data can be collected consistently and is easy to understand and use. A total of 65% of the indicators were not well defined.
 - Performance indicators must be verifiable, meaning that it must be possible to validate the processes and systems that produced the indicator/measure. A total of 80% of the indicators were not verifiable.
 - Performance targets must be measurable. I could not measure the required performance for 20% of the targets.
31. This was because management did not adhere to the requirements of the FMPPI due to a lack of proper systems and processes and technical indicator descriptions.

Reliability of reported performance information

32. The FMPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets.
33. I was unable to obtain the information and explanations I considered necessary to satisfy myself as to the reliability of the reported performance information. This was due to limitations placed on the scope of my work due to the absence of information systems and the fact that the auditee could not provide sufficient appropriate evidence in support of the reported performance information.

Additional matters

34. I draw attention to the following matter:

Achievement of planned targets

35. Refer to the annual performance report on pages 2 and 3 to 28 for information on the achievement of the planned targets for the year. This information should be considered in the context of the material findings on the usefulness and reliability of the reported performance information for the selected development objectives reported in paragraphs 22 to 31 of this report.

Compliance with legislation

36. I performed procedures to obtain evidence that the municipality had complied with applicable legislation regarding financial matters, financial management and other related matters. My findings on material non-compliance with specific matters in key legislation, as set out in the general notice issued in terms of the PAA, are as follows:

Annual reports and financial statements

37. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements of current assets, liabilities, expenditure, disclosure items identified by the auditors in the submitted financial statements were subsequently corrected and the supporting records were provided subsequently, but the uncorrected material misstatements and supporting records that could not be provided resulted in the financial statements receiving a qualified audit opinion.

Strategic planning and performance management

38. The annual performance report for the year under review did not include measures taken to improve performance, as required by section 46(1)(a) of the MSA.

39. The municipality did not establish a proper performance management system, as required by section 38(a) of the MSA.

40. The adopted integrated development plan (IDP) did not reflect and identify the municipal council's vision for the long term development of the municipality and a financial plan, as required by sections 26 and 41 of the MSA, as well as *Municipal planning and performance management regulation* 2(1)(c).

41. The local community was not afforded the opportunity to comment on the final draft of the integrated development plan (IDP) before adoption, as required by section 42 of the MSA and *Municipal planning and performance management regulation* 9, 13(1), 13(4)(c) and 15(3).

42. Revisions to the service delivery and budget implementation plan were not approved by the council after the approval of the adjustments budget, as required by section 54(1)(c) of the MFMA.

43. The annual performance agreements for the municipal manager and all senior managers are not linked to the measurable performance objectives approved with the budget and to the service delivery budget implementation plan as required in terms of section 53(1)(c)(iii) of the MFMA and section 57(1)(b) of the MSA.

Budgets

44. Expenditure was incurred in excess of the limits of the amounts provided for in the votes of the approved budget, in contravention of section 15 of the MFMA.

Procurement and contract management

45. Contracts and quotations were awarded to bidders who did not submit a declaration on whether they are employed by the state or connected to any person employed by the state, as required by SCM regulation 13(c).
46. Construction contracts were awarded to contractors that were not registered with the Construction Industry Development Board (CIDB), in accordance with section 18(1) of the Construction Industry Development Board Act, 2000 (Act no. 38 of 2000) (CIDB Act) and CIDB regulations 17 and 25(7A).
47. Construction projects were not always registered with the CIDB, as required by section 22 of the CIDB Act and CIDB regulation 18.
48. The performance of contractors or providers was not monitored on a monthly basis, as required by section 116(2)(b) of the MFMA.
49. The contract performance and monitoring measures and methods were insufficient to ensure effective contract management, as required by section 116(2)(c) of the MFMA.
50. Awards were made to providers who are in the service of other state institutions in contravention of MFMA 112(j) and SCM regulations 44. Similar awards were identified in the prior year and no effective steps were taken to prevent or combat the abuse of the SCM process in accordance with SCM regulation 38(1).
51. Persons in service of the municipality whose close family members had a private or business interest in contracts awarded by the municipality failed to disclose such interest, as required by SCM regulation 46(2)(e).

Consequence management

52. Unauthorised, irregular, fruitless and wasteful expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, as required by section 32(2)(a)(ii) of the MFMA.

Asset management

53. An effective system of internal control for assets (including an asset register) was not in place, as required by section 63(2)(c) of the MFMA.

Expenditure management

54. An adequate management, accounting and information system was not in place which recognised expenditure when it was incurred, accounted for creditors and accounted for when payments made, as required by section 65(2)(b) of the MFMA.
55. Reasonable steps were not taken to prevent unauthorised, irregular and fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.

Revenue management

- 56. An adequate management, accounting and information system which accounts for revenue and debtors was not in place, as required by section 64(2)(e) of the MFMA.
- 57. An effective system of internal control for revenue was not in place, as required by section 64(2)(f) of the MFMA.

Human resource management

- 58. An acting municipal manager was appointed for a period of more than three months without the approval by the MEC for local government in contravention of section 54A(2A) of the MSA.
- 59. The director of Development Planning and Corporate Service was appointed without having met the prescribed minimum competency levels as required by section 56(1)(b) of the MSA.
- 60. Managers directly accountable to municipal managers were appointed without submitting proof of previous employment and disclosure of financial interests in contravention of regulation 4 of GNR 805.
- 61. The municipality did not submit a report on compliance with prescribed competency levels to the National Treasury and relevant provincial treasury as required by the *Regulations on Minimum Competency Levels*, regulation 14(2)(a).
- 62. The annual report of the municipality did not reflect information on compliance with prescribed minimum competencies as required by the *Regulations on Minimum Competency Levels*, regulation 14(2)(b).
- 63. Senior managers did not meet any of the prescribed competency areas as required by regulation 6 and 7 of the *Regulations on Minimum Competency Levels*.
- 64. Finance officials at middle management did not have the higher education qualification as required by regulation 8 and 9 of the *Regulations on Minimum Competency Levels*.
- 65. Supply chain management managers did not meet any of the prescribed competency areas as required by regulation 8 and 9 of the *Regulations on Minimum Competency Levels*.

Liability management

- 66. An adequate management, accounting and information system which accounts for liabilities was not in place, as required by section 63(2)(a) of the MFMA.

Internal control

- 67. I considered internal control relevant to my audit of the financial statements, annual performance report and compliance with legislation. The matters reported below are limited to the significant internal control deficiencies that resulted in the basis for qualified opinion, the findings on the annual performance report and the findings on non-compliance with legislation included in this report.

Leadership

- 68. The municipality did not have sufficient monitoring controls to ensure the proper implementation of the overall process of planning, budgeting, implementation and reporting.
- 69. Adequate internal policies and procedures for performance information management and reporting were not developed and approved.

Financial and performance management

70. The municipality did not formulate and implement a record management policy and related procedures to ensure that all documentation is properly controlled.
71. Management did not implement the following daily and monthly controls as designed for the entity's business processes:
- The municipality did not perform reconciliations between the general ledger and the fixed asset register due to a lack of skills.
72. The financial statements contained numerous misstatements that were corrected. This was mainly due to staff members not fully understanding the requirements of the financial reporting framework.
73. Design and implementation of formal controls over IT systems to ensure the reliability of the systems and the availability, accuracy and protection of information was not implemented.
74. Regular accurate and complete financial and performance reports that are supported and evidenced by reliable information were not adequately implemented.
75. The municipality did not adequately reconcile transactions related to inventory and property, plant and equipment. This is attributable to a lack of review and monitoring.

Governance

76. The internal audit function had capacity problems during the year under review and therefore did not complete all the relevant audits as per the internal audit plan.

Auditor-General

Polokwane

28 November 2014



**AUDITOR - GENERAL
SOUTH AFRICA**

Auditing to build public confidence